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No. 82-500

IN THE

Supreme Court of the United States

OCTOBER TERM, 1982

THE SOUTHLAND CORPORATION, *et al.*,
Appellants,

v.

RICHARD D. KEATING, *et al.*,
Appellees.

On Appeal from the Supreme Court of California

BRIEF OF APPELLANTS

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March 1983

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTIONS PRESENTED

1. Whether a state statute violates the Supremacy Clause of the United States Constitution when it invalidates arbitration agreements involving interstate commerce that are "valid, irrevocable, and enforceable" under the terms of the Federal Arbitration Act.

2. Whether the federally protected right of arbitration under the Federal Arbitration Act is unlawfully impaired when a state court superimposes judicial class action procedures (including court-supervised discovery, briefing, certification, notice and opt-out procedures, mandatory preparation of transcripts, and ongoing judicial control) on a private arbitration of a commercial dispute involving interstate commerce.

PARTIES BELOW

This appeal involves eight cases that were consolidated in the court below.* Plaintiffs, who are former franchised operators of 7-Eleven® convenience stores in the State of California, are Richard and Darla Keating, Edward and Betty Gouveia, Harry Battersby, Patrick and Cathy Cheng, Michael and Gloria Coy, Phillip and Joan Newell, Thomas and Wanda Sampson, and Arthur and Jenny Scovis. Some of the plaintiffs purport to represent a class consisting of all current and former 7-Eleven franchisees in California.

Defendants are The Southland Corporation, which owns the 7-Eleven® service mark, and several of its current and former officers, directors and employees: John P. Thompson, Jere W. Thompson, Walton Grayson, III, Joseph S. Hardin, R. G. Smith, Eugene Pender, S. R. Dole, Terry De Bard, Gene Janssen, Curtis Pare, Ray Berry, Paul Stevenson, Michael Wildman, Robert Johnson, Ernest Arzabal, Michael Drury, Keith Jenkins, Robert Duncan, Fred Elwood, Joseph Galea, Dave Pava, Tal Colson and Douglas Porter.

Defendant The Southland Corporation has no parent corporation, subsidiaries (except wholly owned subsidiaries), or affiliates.

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* One additional case, *Garza* v. *Southland*, was originally consolidated with the others but has since been settled.

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THE SOUTHLAND CORPORATION, *et al.*,
Appellants,

v.

RICHARD D. KEATING, *et al.*,
Appellees.

On Appeal from the Supreme Court of California

BRIEF OF APPELLANTS

Appellants, The Southland Corporation and several of its current and former officers, directors and employees (hereinafter collectively referred to as "Southland"), appeal from a decision of the Supreme Court of California.

OPINIONS BELOW

The majority and dissenting opinions of the California Supreme Court are reported at 31 Cal. 3d 584, 183 Cal. Rptr. 360, 645 P.2d 1192 (1982), and are reprinted in the separate Appendix to appellants' Jurisdictional Statement at 1a-45a (hereinafter "J.S. App."). The opinion of the California Court of Appeal, First District, is reported at 109 Cal. App. 3d 784, 167 Cal. Rptr. 481

(1980), and is reprinted at J.S. App. 47a-70a. The orders of the Superior Court of Alameda County (J.S. App. 71a-80a) are unreported.

JURISDICTION

The judgment of the Supreme Court of California was entered on June 10, 1982, and a timely notice of appeal was filed by Southland. (J.S. App. 83a-84a.) After receiving an extension of time to docket its appeal (J.S. App. 85a), Southland filed its Jurisdictional Statement on September 22, 1982 pursuant to 28 U.S.C. § 1257(2). On January 10, 1983 the Court ordered that "[f]urther consideration of the question of jurisdiction is postponed to the hearing of the case on the merits." 103 S. Ct. 721 (1983). (Joint Appendix at 36 [hereinafter "J.A."].) The grounds upon which this Court's jurisdiction is invoked are discussed in greater detail at pages 11-23, below.

CONSTITUTIONAL PROVISIONS AND STATUTES INVOLVED

The following constitutional and statutory provisions are involved in this appeal:

28 U.S.C. § 1257 (1976). State courts; appeal; certiorari

> Final judgments or decrees rendered by the highest court of a State in which a decision could be had, may be reviewed by the Supreme Court as follows:
>
> . . . .
>
> (2) By appeal, where is drawn in question the validity of a statute of any state on the ground of its being repugnant to the Constitution, treaties or laws of the United States, and the decision is in favor of its validity.

U.S. Const. art. VI, cl. 2 (the Supremacy Clause)

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; . . . shall be the supreme Law of the Land; and the

Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

Section 2 of the Federal Arbitration Act (9 U.S.C. § 2 (1976))

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

California Franchise Investment Law, Cal. Corp. Code § 31512 (West 1977)

Any condition, stipulation or provision purporting to bind any person acquiring any franchise to waive compliance with any provision of this law or any rule or order hereunder is void.

STATEMENT OF THE CASE

This appeal concerns a decision of the California Supreme Court, holding that the California legislature is free to carve out exceptions to the Federal Arbitration Act, 9 U.S.C. §§ 1-14 (1976). This appeal also challenges the California Supreme Court's decision that a party to an arbitration agreement governed by the Federal Arbitration Act is entitled to petition a court to direct his arbitration claim to proceed on a "class action" basis. The court rejected Southland's argument that the state statute and class action procedures are inconsistent with the goals and procedures of arbitration under the Federal Arbitration Act, and therefore are preempted by the federal law.

The litigation began in May 1977 with the filing of an action by Richard and Darla Keating in the Superior Court for Santa Clara County, California. Plaintiffs were franchised operators of a 7-Eleven® convenience store. They alleged that their franchisor, Southland, had utilized an accounting system in preparing financial statements for their store that was unfair and inaccurate, and that representatives of Southland had made certain fraudulent representations concerning the accounting system. Southland's conduct was alleged to give rise to several related causes of action, including common law fraud, breach of contract, breach of fiduciary duty, and a violation of the California Franchise Investment Law.[1] Plaintiffs purported to represent a class of all current and former 7-Eleven franchisees in California.[2] Thereafter, several other 7-Eleven franchisees who had previously filed lawsuits against Southland in various California state courts amended their complaints to conform to the allegations in *Keating*, and they successfully petitioned the state Judicial Council to coordinate all of the cases in one trial court.

Southland filed a motion to compel arbitration in *Keating* pursuant to an arbitration clause in the franchise agreement, which provided that the parties would arbitrate "any controversy or claim arising out of or relating

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[1] The California Franchise Investment Law requires franchisors to make certain disclosures to prospective franchisees, and prohibits franchisors from making fraudulent or misleading statements to those prospective franchisees. Cal. Corp. Code §§ 31000-31516 (West 1977 & 1982 Supp.). In essence, it establishes a specific statutory cause of action for certain fraudulent conduct. Plaintiffs' claim under this statute is based on the same facts as, and is largely duplicative of, plaintiffs' various common law causes of action.

[2] Plaintiffs' original complaint alleged a class consisting of all current and former 7-Eleven franchisees in the United States, but the scope of the purported class was narrowed to California franchisees in an amended complaint filed in January 1978. Plaintiffs alleged that there were in excess of 800 persons in this amended "class." (J.A. at 15.)

to this Agreement or the breach hereof . . . in accordance with the Rules of the American Arbitration Association . . . ." Southland promptly filed similar motions in the other consolidated cases after plaintiffs in those actions amended their pleadings to assert the complex accounting issues that had been raised in the *Keating* complaint.[3]

Plaintiffs in each case resisted arbitration on a variety of grounds. Among their contentions was that claims based on the California Franchise Investment Law are nonarbitrable by virtue of a statutory provision that renders void any contract clause requiring a franchisee to "waive" his rights under that law. Cal. Corp. Code § 31512 (West 1977) (reprinted *supra* at p. 3.) As a fallback position, plaintiffs suggested that if their claims were arbitrable, the court should create a procedure whereby the arbitration would be conducted as a class action.

The Superior Court held that plaintiffs were required to arbitrate their claims of common law fraud, breach of contract and breach of fiduciary duty, but not their claims under the Franchise Investment Law. (*See* J.S. App. 72a, 74a, 79a.)[4] The court did not reach the issue whether the arbitration should proceed as a class action.

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[3] The original pleadings in the cases filed prior to *Keating* had primarily alleged oral misrepresentations by various employees of Southland concerning the prospective sales, profitability, etc. of the plaintiffs' stores. The California Supreme Court noted that the amended complaints substantially changed the focus of plaintiffs' claims, and it rejected plaintiffs' contention that Southland had waived its right to demand arbitration in these cases. (J.S. App. 21a-22a.)

Plaintiffs in all of the coordinated cases were represented by the same attorneys. However, rather than joining in the purported class action in *Keating*, several of the plaintiffs chose to continue the prosecution of their own cases.

[4] The Superior Court's orders did not explain the reasons for denying arbitration of the Franchise Investment Law claims.

Southland appealed from the court's refusal to compel arbitration of the Franchise Investment Law claims. The franchisees, in turn, filed a petition for a writ of mandamus or prohibition in which they argued, *inter alia*, that the arbitration should proceed as a class action. (*See* J.S. App. 48a.)[5]

The California Court of Appeal rejected plaintiffs' argument that the Franchise Investment Law invalidates arbitration agreements. (J.S. App. 66a-68a.) It further concluded that if the statute were interpreted to contain such a provision, it would be invalid with respect to contracts involving interstate commerce because the Federal Arbitration Act provides that such arbitration agreements are "valid, irrevocable, and enforceable." (J.S. App. 68a-70a.) The court therefore held that the Franchise Investment Law claims were arbitrable along with the remainder of plaintiffs' causes of action. (J.S. App. 70a.) The Court of Appeals also ruled, however, that there was no "insurmountable obstacle" to conducting an arbitration on a classwide basis (J.S. App. 63a), and it

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However, the trial judge later explained on the record (i) that in his view, the arbitration clause in the 7-Eleven franchise agreement was not broad enough to include these claims, and (ii) that he therefore had not reached plaintiffs' argument that Franchise Investment Law claims were nonarbitrable. Transcript of Hearing of July 19, 1978, at 20-24, *Market Franchise Cases*, Cal. Jud. Council Coord. No. 387 (Cal. Super. Ct., Alameda Co.), *reprinted in* Reporter's Transcript on Appeal to California Court of Appeal 86, 105-09. The Superior Court's narrow construction of the contract was reversed by the California Court of Appeal (J.S. App. 65a-66a), and that ruling was not disturbed by the California Supreme Court.

[5] Under California law, a court's refusal to compel arbitration is treated as an appealable order, *see* Cal. Code Civ. Proc. § 1294(a) (West 1982), but an order compelling arbitration is nonappealable and is subject to immediate review only by a writ of prohibition or mandamus. *E.g., La Pietra* v. *Freed*, 87 Cal. App. 3d 1025, 1030-31, 151 Cal. Rptr. 554, 557 (1978).

issued a writ of mandate directing the trial court to conduct class certification proceedings. (J.S. App. 64a.)

The California Supreme Court, by a divided vote of 4-2, reversed the Court of Appeal's ruling that claims asserted under the California Franchise Investment Law are arbitrable. It concluded that the California legislature intended to render arbitration agreements unenforceable with respect to claims based on that statute, and it held further that anti-arbitration statutes of this kind do not contravene the federal substantive law embodied in the Federal Arbitration Act. (J.S. App. 8a-18a.)

The California Supreme Court, again by a 4-2 majority, affirmed the Court of Appeal's ruling on the availability of a class action arbitration procedure. (J.S. App. 23a-30a.) Although it acknowledged that the Federal Arbitration Act was applicable and controlling (J.S. App. 4a-5a), the court based its decision on a California public policy favoring class actions. Consequently, the court held that a class action arbitration could be imposed upon the parties without their mutual consent.

The majority did not directly address Southland's argument that a class action would be fundamentally inconsistent with arbitration, which is intended to be a simple, quick, inexpensive and nonjudicial procedure. The court acknowledged, however, that "[w]ithout doubt a judicially ordered classwide arbitration would entail a greater degree of judicial involvement than is normally associated with arbitration," including initial class certification and "a measure" of ongoing judicial supervision "in order to safeguard the rights of absent class members to adequate representation and in the event of dismissal or settlement." (J.S. App. 28a-29a.) The court contemplated that the trial court would authorize discovery and briefing on the class action issue; determine whether a class action was appropriate; supervise any notice and opt-out procedures; oversee the arbitration proceedings themselves to ensure that the interests of the class were being

adequately represented by the named claimants and adequately protected by the arbitrators; and review any dismissal or settlement. (*See* J.S. App. 29a.) The majority also acknowledged that the trial court would have to exercise "[a] good deal of care, and ingenuity" in order to supervise the arbitration proceedings in these ways while "avoid[ing] judicial intrusion upon the merits" and "minimiz[ing] complexity, costs, or delay." (J.S. App. 29a.)

The dissenting justices (Richardson and Mosk, J.J.) disagreed with the majority on both issues. (J.S. App. 30a-45a.) First, with respect to the California Franchise Investment Law question, they referred to the long line of authority establishing that the Federal Arbitration Act creates a body of federal substantive law that supersedes any state policies seeking to invalidate arbitration agreements involving interstate commerce. (J.S. App. 32a-34a.) They disagreed with the majority's view that the states are free to carve out exceptions to the federal statute. (J.S. App. 37a.) Second, the dissenting justices rejected the propriety of a class action arbitration, concluding that it would be "fundamentally contrary to the purpose of arbitration and to the public policy encouraging arbitration." (J.S. App. 44a.) They noted the absence of statutory or precedential authority for the procedure; catalogued ways in which courts inevitably would supervise, review and interfere with arbitrators' actions; and then concluded that the majority's newly-fashioned procedure "would tend to make arbitration inefficient instead of efficient, lengthy instead of expeditious, and procedural instead of informal." (J.S. App. 41a.)

SUMMARY OF ARGUMENT

I. The Court has jurisdiction over this case pursuant to 28 U.S.C. § 1257(2) because the decision of the California Supreme Court constitutes a "final judgment" regarding the validity of a state statute and procedures that were "drawn into question" in the court below.

A. Under the principles established by this Court in cases such as *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949), and *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469 (1975), the decision of the court below is "final," notwithstanding the fact that the California court directed judicial proceedings to continue in the trial court, because the decision deals with issues that (i) have been finally adjudicated by the state court, (ii) are collateral to the merits, (iii) are novel and important, and (iv) cannot meaningfully be reviewed after the proposed judicial proceedings have run their course. Appellants' right to avoid the delays and costs of litigation in the courts must be determined now, or it will effectively be lost forever. Additional factors favoring prompt appellate review are the facts (v) that the decision of the California court would erode the strong public policy favoring arbitration under the Federal Arbitration Act, and (vi) that reversal by this Court of the California court's decision would terminate the court proceedings so that the parties could proceed immediately to resolve their disputes in a nonjudicial forum.

Furthermore, one of the two questions presented (the class action arbitration issue) was adjudicated in a separate proceeding brought by the appellees for a writ of mandamus or prohibition. The final disposition of that separate proceeding is an appealable final judgment.

B. The issues raised by this appeal were presented to, and were ruled upon, by the California Supreme Court. Appellees' claim that appellants failed to litigate one of the two issues (the class action issue) is erroneous.

II. Under the terms of the Federal Arbitration Act, agreements to arbitrate commercial disputes involving interstate commerce are "valid, irrevocable, and enforceable." 9 U.S.C. § 2. The Act provides that an interstate arbitration agreement can only be struck down on the

basis of general contract principles that apply to all contracts (*e.g.*, duress, lack of legal capacity). The Act creates "a body of federal substantive law of arbitrability" that favors arbitration agreements, "notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 51 U.S.L.W. 4156, 4162 (U.S. Feb. 23, 1983). Thus, the Supremacy Clause of the United States Constitution preempts state statutes that purport to invalidate agreements that are made "valid, irrevocable, and enforceable" by the Federal Arbitration Act.

The California Franchise Investment Law attempts to block the enforcement of arbitration agreements. This anti-arbitration provision applies regardless of whether the arbitration agreement was willingly executed by persons having legal capacity, and regardless of whether the agreement provides for a fair and impartial resolution of the parties' dispute. The case at bar involves a contract in interstate commerce. Accordingly, under the Supremacy Clause, the California statute must give way to the strong federal policy favoring arbitration.

III. The California Supreme Court has improperly attempted to superimpose judicial class action procedures onto private arbitrations of commercial disputes under the Federal Arbitration Act. The mechanism created by the court below would be enormously complex, expensive and time-consuming, and would be conducted by a court from start to finish. The state court's unprecedented procedure is fundamentally at odds with the purposes and procedures of arbitration, which is intended to be simple, economical, quick and, most importantly, nonjudicial. Accordingly, as applied to interstate contracts, the decision of the California Supreme Court is an improper, destructive interference with a federally protected right, and should be invalidated by this Court.

ARGUMENT

I. THE COURT HAS JURISDICTION OVER THIS CASE

This Court has jurisdiction pursuant to 28 U.S.C. § 1257(2) (1976), which confers appellate jurisdiction over final judgments or decrees rendered by the highest court of a state where the validity of a state statute is drawn into question on the ground of its being repugnant to federal law and the state court has upheld the challenged statute. In the case at bar, Southland drew into question the validity of the California Franchise Investment Law and class action rules as applied to arbitration proceedings governed by the Federal Arbitration Act. The California Supreme Court's decision regarding these issues constitutes a "final judgment or decree" within the meaning of Section 1257(2).

A. The Decision of the California Supreme Court Constitutes a Reviewable Final Decision

1. *The Ruling on the Nonarbitrability of Claims Under the California Franchise Investment Law Is Final*

The highest court of California has held that arbitration agreements are unenforceable with respect to claims asserted under the state's Franchise Investment Law. This ruling is not subject to further review in the state courts, and it does not leave any discretion to the trial judge to honor Southland's demand for arbitration.

The California Supreme Court's ruling does not terminate the judicial proceedings. However, it is precisely this fact that will cause the injury for which Southland seeks redress in this appeal. Arbitration is intended to be speedy, economical and *nonjudicial*; and the Federal Arbitration Act calls for "mov[ing] the parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." *Moses H. Cone Memorial Hospital* v. *Mercury Construction Corp.*, 51 U.S.L.W.

4156, 4161 (U.S. Feb. 23, 1983). Thus, an appeal to this Court after the completion of years of further judicial proceedings could never restore the benefits of arbitration or the protection of the federal statute. If there is to be a meaningful appeal, it must occur now.

"Finality" does not depend on whether the judicial proceedings in the trial court are at an end. *See Hudson Distributors, Inc.* v. *Eli Lilly & Co.*, 377 U.S. 386, 389 n.4 (1964). Rather, determinations of finality are based on a balancing of " 'the inconvenience and costs of piecemeal review on the one hand and the danger of denying justice by delay on the other.' " *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 171 (1974) (citation omitted). The Court thus employs an "intensely 'practical' approach . . . when applying the finality requirements of . . . 28 U.S.C. § 1257." *Mathews* v. *Eldridge*, 424 U.S. 319, 331 n.11 (1976) (citations omitted). *See also Gillespie* v. *United States Steel Corp.*, 379 U.S. 148, 152-54 (1964).

This Court has ruled that an order denying a stay of judicial proceedings pending arbitration should not routinely be treated as an appealable final judgment.[6] The Court has also recognized, however, that decisions regarding arbitrability constitute final judgments in some circumstances,[7] and that an immediate appeal is appropriate if a decision meets the standards for reviewing a collateral or separable order.[8]

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[6] *See Baltimore Contractors, Inc.* v. *Bodinger*, 348 U.S. 176, 179 (1955); *Shanferoke Coal & Supply Corp.* v. *Westchester Service Corp.*, 293 U.S. 449, 451 (1935).

[7] *Goodall-Sanford, Inc.* v. *United Textile Workers*, 353 U.S. 550, 551-52 (1957).

[8] *See Baltimore Contractors, Inc.* v. *Bodinger*, 348 U.S. at 179 n.4. The courts have permitted interlocutory appeals from decisions denying enforcement of arbitration agreements in two additional situations which, though not directly applicable here, demonstrate a recognition of the need for effective appellate review. First, when the decision regarding arbitrability is rendered by a *federal* court,

The California court's decree in the case at bar falls within the well-recognized line of cases, epitomized by *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. 541 (1949), and *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. 469 (1975), in which certain separate and collateral decisions are treated as final judgments even though additional proceedings are anticipated in the courts. *Cohen* permits review of a decision which "finally determines claims of right separable from, and collateral to, rights asserted in the action, too important to be denied review and too independent of the cause itself to require that appellate consideration be deferred until the whole case is adjudicated." [9] *Cox* holds that a ruling by a state court on a federal issue should be immediately appealable, despite the expectation of additional state court proceedings, if (i) the federal issue has been finally decided in

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interlocutory appellate review is often available under 28 U.S.C. § 1292(a)(1) (1976). *See, e.g., Shanferoke Coal & Supply Corp.* v. *Westchester Service Corp.*, 293 U.S. at 451-52; *Ingbar* v. *Drexel Burnham Lambert Inc.*, 683 F.2d 603, 604 (1st Cir. 1982). Second, if one party files a lawsuit and the other party seeks to enforce the arbitration agreement by filing a *separate* judicial action to compel arbitration, the trial court's decision in that separate action is appealable. *See, e.g., Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4157-59; *University Life Ins. Co. of America* v. *Unimarc Ltd.*, 1982-83 (CCH) Trade Cas. ¶ 65,139, at 71,459-61 (7th Cir. 1983).

For a general discussion of the principles applicable to appeals from decisions regarding arbitrability, *see* Note, *Interlocutory Appeal of Orders Granting or Denying Stays of Arbitration*, 80 Mich. L. Rev. 153 (1981); Dyk, *Appealability of Interlocutory Orders Enjoining or Refusing to Enjoin Commercial Arbitration*, 69 Ky. L.J. 827 (1980-81); Note, *Restraining Effects of the Final Judgment Rule on the Arbitration Process*, 66 Yale L.J. 293 (1956).

[9] 337 U.S. at 546-47. The Court has restated this rule on numerous occasions. *See, e.g., Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4158; *Firestone Tire & Rubber Co.* v. *Risjord*, 449 U.S. 368, 374-75 (1981); *Coopers & Lybrand* v. *Livesay*, 437 U.S. 463, 468 & n.10 (1978); *Abney* v. *United States*, 431 U.S. 651, 658-59 (1977). *See also National Socialist Party of America* v. *Village of Skokie*, 432 U.S. 43, 44 (1977) (per curiam).

the state courts, (ii) reversal of the state court decision would be preclusive of further litigation on the relevant cause of action rather than merely controlling the nature of the state proceedings, and (iii) refusal to review immediately the state court decision might seriously erode federal policy. 420 U.S. at 482-83.[10]

The California court's resolution of the California Franchise Investment Law issue satisfies these standards.[11] The court's decision conclusively determined the disputed question; is the state court's final word on the matter; will control future litigation; and cannot be relitigated.[12] The issue is also completely separate from the merits of the action. As recognized by the California court, the "issues before [it did] not concern the merits of those disputes, but rather the forum and procedure for their resolution." (J.S. App. 2a.) In addition, reversal by this Court of the state court's decision would terminate the pending judicial litigation, and the parties could then proceed quickly to arbitration. *See Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 482-83.

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[10] The decisions cited in note 6, *supra*, largely predate the development of these doctrines. Several commentators have suggested that, in view of the strong public policy favoring arbitration, orders denying arbitration should be appealable in all instances. *See, e.g.*, Notes, *supra* note 8; Dyk, *supra* note 8. However, irrespective of whether refusals to enforce arbitration agreements should always be treated as final orders, the decision of the California Supreme Court in this case is appealable for the reasons stated herein.

[11] Appellees have not challenged the finality of this issue for purposes of appellate review by this Court. *See* Appellees' Motion to Dismiss, Nov. 23, 1982, at 5-7.

[12] *See, e.g., Davies* v. *Krasna*, 14 Cal. 3d 502, 507, 121 Cal. Rptr. 705, 708, 535 P.2d 1161, 1164 (1975) (law of the case must be adhered to in subsequent proceedings and a matter adjudicated on a prior appeal will not be relitigated on a subsequent appeal in the same case).

Moreover, if review is postponed until the end of the litigation, "it will be too late effectively to review the present order and the rights conferred by the statute . . . will have been lost, probably irreparably." *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. at 546.[13] Given the fact that time-consuming judicial proceedings are the very thing that the parties sought to avoid by agreeing to arbitrate, an appeal after the conclusion of protracted judicial litigation would be only an empty gesture. Indeed, this Court has recently held that in view of the federal statutory policy of "rapid and unobstructed enforcement of arbitration agreements," *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4161, the mere deferral by a trial court of a decision on a motion to compel arbitration can satisfy the *Cohen* doctrine. *Id.* at 4158-59. *A fortiori*, the doctrine is satisfied where, as here, the protection of the federal statute has been conclusively denied by the highest court of the state, and several more years of judicial proceedings are accordingly in the offing.

The standards of *Cohen* and *Cox* are particularly applicable here because the issues presented are "too important to be denied review." *Cohen* v. *Beneficial Industrial Loan Corp.*, 337 U.S. at 546. *See Wilko* v. *Swan*, 346 U.S. 427, 430 (1953). This is not a case in which the state court has simply interpreted the agreement of the parties or determined that the right to demand arbitration was waived in a particular case. The issues here are much broader—namely, the power of the states to enact categories of "exceptions" to the Federal Arbitration Act.

Moreover, denial of prompt review in this case "might seriously erode federal policy." *Cox Broadcasting Corp.*

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[13] *Accord, Firestone Tire & Rubber Co.* v. *Risjord*, 449 U.S. at 376 (quoting *Mathews* v. *Eldridge*, 424 U.S. at 331 n.11).

v. *Cohn*, 420 U.S. at 483. The decision of the California Supreme Court has wide ramifications and opens the door to the creation by California or other states of additional classes of nonarbitrable disputes. Much as in *Local No. 438 Construction & General Laborers' Union* v. *Curry*, 371 U.S. 542, 550 (1963), in which a state court had enjoined picketing on the basis of a state law notwithstanding the National Labor Relations Act and the exclusive jurisdiction of the NLRB, "postponing review would seriously erode the national . . . policy requiring the subject matter of respondents' cause to be heard by the . . . Board [arbitrator], not by the state courts."

Finally, it is appropriate for this Court to consider the important issues presented herein at this juncture because, if the case at bar is tried in the California state court and Southland prevails, "there would remain in effect the unreviewed decision of the State Supreme Court" that states may choose to supersede the policies of the Federal Arbitration Act. *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 485. *Accord, Miami Herald Publishing Co.* v. *Tornillo*, 418 U.S. 241, 247 n.6 (1974).

This Court has reviewed appeals in a number of analogous situations. For instance, the denial of a motion to dismiss an indictment on the ground that retrial would expose the defendant to double jeopardy has been held to be an appealable decision. *Abney* v. *United States*, 431 U.S. 651 (1977); *Harris* v. *Washington*, 404 U.S. 55, 56 (1971) (per curiam). The Court recognized in these cases that a second trial would irreparably injure the defendant, irrespective of the ultimate outcome, since the double jeopardy clause is designed to protect a person from being subjected to a second judicial proceeding. As this Court stated in *United States* v. *MacDonald*, 435 U.S. 850, 861 (1978), "a 'right not to be tried' . . . must be upheld prior to trial if it is to be enjoyed at all." The same is true of arbitration. *See also Helstoski* v. *Meanor*, 442 U.S. 500, 506-08 (1979).

This case is also similar to *Mercantile National Bank* v. *Langdeau*, 371 U.S. 555 (1963), in which the Court reviewed as a final judgment a state court's determination of venue, which determination implicated federal law.[14] The Court held that:

> it serves the policy underlying the requirement of finality in 28 U.S.C. § 1257 to determine now in which state court appellants may be tried rather than to subject them, and appellee, to long and complex litigation which may all be for naught if consideration of the preliminary question of venue is postponed until the conclusion of the proceedings.

Id. at 558. As in *Langdeau*, this appeal raises important issues of general applicability concerning the appropriate forum for litigating the dispute.

While concern about unnecessary federal intrusion into state affairs often militates against interlocutory review of a state court decision,[15] there is no such danger here. Under California law, a denial of arbitration is an appealable order[16] and, in fact, *must* be appealed immediately, if at all.[17] For this reason, the case at bar has already been reviewed fully by both the California Court of Appeal and Supreme Court. It would thus be wasteful

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[14] *Accord, American Motorists Insurance Co.* v. *Starnes*, 425 U.S. 637, 642 n.3 (1976).

[15] *See, e.g., North Dakota State Board of Pharmacy* v. *Snyder's Drug Stores, Inc.*, 414 U.S. 156, 159 (1973).

[16] *See* Cal. Code Civ. Proc. § 1294(a). This statute was the basis for Southland's appeals to the California Court of Appeal and Supreme Court.

[17] "The law of this state does not allow, on appeal from a judgment, a review of any decision or order from which an appeal might previously have been taken . . . ." *Morrissey* v. *City and County of San Francisco*, 75 Cal. App. 3d 903, 906, 142 Cal. Rptr. 527, 529 (1977), *hearing denied* (Cal. Sup. Ct. 1978) (citations omitted). *See* Cal. Code Civ. Proc. § 906 (West 1980).

of judicial resources, and pointless, to require this case to work its way through the state court system again before this Court reviews the important issues presented. *Cf. Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4163. Such a procedure would "result in a completely unnecessary waste of time and energy in judicial systems already troubled by delays due to congested dockets." *Mills* v. *Alabama*, 384 U.S. 214, 217-18 (1966).

2. *The Ruling on the Class Action Issue Is Final*

The California court's decision on the class action arbitration issue is independently appealable as a final judgment. This issue was decided on a writ of prohibition, obtained in a proceeding brought by the franchisees in the California Court of Appeal. (*See supra* pp. 6-7.) It is settled that a state court's final disposition of such a writ is a final judgment reviewable under Section 1257. *See Fisher* v. *District Court*, 424 U.S. 382, 385 n.7 (1976) (per curiam) (and cases cited therein).[18]

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[18] The appellee-franchisees initiated a proceeding in the Court of Appeal seeking such a writ, arguing that the trial court had "acted without or in excess of its jurisdiction" by, *inter alia*, denying them a class arbitration. *See* [Plaintiffs'] Petition for Writs of Mandate or Prohibition, Oct. 3, 1978, at 4-5. (*See also* J.S. App. 48a.) Particularly under California law, such a proceeding "is a distinct suit and the judgment finally disposing of it is a final judgment within the meaning of [what is now Section 1257]." *Bandini Petroleum Co.* v. *Superior Court*, 284 U.S. 8, 14 (1931). *Accord, Rescue Army* v. *Municipal Court*, 331 U.S. 549, 565 (1947). The Court of Appeal granted the writ (J.S. App. 64a), which constituted a final judgment on the matter, *see* Cal. Code Civ. Proc. § 1064 (West 1980), and, under California law, Southland was required immediately to exercise its right of appeal if it wished to obtain any review of the decision. *See id.* §§ 1110 (West 1980), 906; *supra* note 17. The California Supreme Court affirmed the decision and therefore finally disposed of the writ.

In addition, the *Cohen* and *Cox* doctrines, discussed above, are equally applicable to the class action arbitration question. The class action issue poses a collateral matter, separate from the underlying merits of the case. Moreover, a reversal by this Court of the state court's decision would not merely control the nature and character of the judicial proceedings, but would terminate those proceedings so that the parties could proceed promptly to the arbitration forum. *Cox Broadcasting Co.* v. *Cohn*, 420 U.S. at 482-83. The California Supreme Court's creation of a class action arbitration procedure poses important issues of first impression, and threatens to erode the strong federal policy favoring nonjudicial arbitration under the Federal Arbitration Act. (*See* the discussion *infra* at pp. 30-42.)

In their motion to dismiss this appeal, at 6-7, appellees argued that there is no final judgment since no class has yet been certified and since Southland might be able to persuade the trial court to refuse to certify a class. This misses the point, for once a trial court initiates class certification proceedings—including discovery, briefing and a decision, a process bound to take many months—Southland will irretrievably lose its right to be relieved of the costs and delays associated with such judicial proceedings. Regardless of whether the trial court eventually certifies a class, the parties will have been forced to run the gauntlet of expensive and time-consuming procedures in direct contradiction to "the unmistakably clear congressional purpose [in the Federal Arbitration Act] that the arbitration procedure, when selected by the parties to a contract, be speedy and not subject to delay and obstruction in the courts." *Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. 395, 404 (1967). *Accord, Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4161 (clear intent of Act is "to move the

parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible").

Even if Southland prevails in the further proceedings, "there would remain in effect the unreviewed decision of the State Supreme Court" [19] that class action arbitrations may go forward. This time-consuming judicial procedure, which could be used in a wide variety of situations, would discourage arbitration and would increase the burdens on the judicial system.[20]

Thus, applying the "pragmatic approach" by which this Court determines finality for purposes of review, the judgment of the California Supreme Court is a final judgment under 28 U.S.C. § 1257(2).

B. The Issues Presented in This Appeal Were Raised and Litigated in the California Courts

Appellees argued in their motion to dismiss this appeal, at 5-6, that this Court lacks jurisdiction over one of the questions presented (the class action arbitration issue) because Southland allegedly failed to raise that issue in the California courts.[21] Appellees' claim is without merit.

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[19] *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 485. *Accord*, *Miami Herald Publishing Co.* v. *Tornillo*, 418 U.S. at 247 n.6.

[20] *Cf. Mills* v. *Alabama*, 384 U.S. at 217-18; *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4163.

[21] The other issue presented by this appeal (*i.e.*, the incompatibility of the Federal Arbitration Act and the anti-arbitration policy in the state's Franchise Investment Law) was raised by the *appellees* in the California Supreme Court. The California Court of Appeal had ruled against the franchisee-plaintiffs on this issue (*see* J.S. App. 66a-70a), and they asked the California Supreme Court to overturn that decision. (*See* [Plaintiffs'] Answer to [Southland's] Petition for Hearing, Oct. 17, 1980, at 31-38.) The California Supreme Court's decision directly addressed the question whether individual states are free to enact statutes overriding the Federal Arbitration Act. (*See* J.S. App. 13a-18a.)

In Southland's petition for hearing in the California Supreme Court, it framed the question presented as "[w]hether a court may enter an order compelling a private commercial arbitration governed by the Federal Arbitration Act and the rules of the American Arbitration Association to proceed as a class action . . . ." (Pet. for Hearing at 2.) Southland argued in its brief that "[u]nder both federal and California law" arbitration is highly favored (*id.* at 6); arbitration is intended to operate outside the judicial system; a class action arbitration would require intimate judicial involvement; and class action procedures would effectively eliminate the benefits of arbitration as a quick, inexpensive, informal alternative to judicial proceedings. (*Id.* at 6-22.) Southland further contended that a class action arbitration would deny absent class members due process of law unless a court closely supervised the arbitrator's conduct, which control would destroy arbitration as the nonjudicial remedy which it is intended to be. (*Id.* at 10-19.) Approximately sixty federal court decisions were cited in Southland's brief in support of these propositions.

Appellees contend that Southland should be deemed to have failed to raise the federal issue because it also relied on state court decisions and on "general policies in favor of arbitration" (Motion to Dismiss at 5-6), and did not argue in the court below "that the Federal Arbitration Act, *as opposed to* the California statute, barred the class action . . . ." (*Id.* at 6 n.2 (emphasis supplied).) However, in view of the fact that this case was pending in state court, it was obviously relevant to direct the court's attention to its own precedents, as well as to decisions rendered by federal courts. Moreover, since Southland and the appellee-franchisees had already *agreed* in the lower courts that the Federal Arbitration Act governed this case, it was unnecessary for Southland to argue at length that the policies of the federal statute—as opposed to the state arbitration law—would be affected by a class

action.[22] Precedents from both federal and state courts were thus germane to the issues presented before the California court.[23]

Where the record before this Court shows that, "either expressly or by clear intendment," a claim as to the invalidity of a state law was brought to the attention of a state court, this Court will regard the claim "as having been adequately presented." *PruneYard Shopping Center* v. *Robins*, 447 U.S. 74, 85 n.9 (1980) (quoting *New York ex rel. Bryant* v. *Zimmerman*, 278 U.S. 63, 67 (1928)). If the state court "actually entertains and decides [the] question adversely to the federal right asserted," [24] or if "the necessary effect of the judgment has been to deny the [federal] claim," then this Court's appellate jurisdiction is invoked.[25]

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[22] In the California Court of Appeal, the franchisee-plaintiffs noted that they "have not challenged Southland's contention that . . . the Federal Arbitration Act is applicable." (Petitioners' Supp. Mem. in re Arbitration in a Class Action, July 10, 1979, at 7.) The Court of Appeal accordingly had no difficulty in concluding that the federal Act governed the case. (J.S. App. 52a-53a.) Thus, in Southland's petition for hearing to the California Supreme Court, it was only necessary to note briefly that "[t]he instant cases are governed by the Federal Arbitration Act, 9 U.S.C. § 1 *et seq.*, since the dispute involves interstate commerce." (Pet. for Hearing at 6 n.6.)

[23] Appellees recognized in the courts below that it was appropriate to rely upon state court decisions even though the class arbitration issue arose under the Federal Arbitration Act. For example, in one of their briefs to the California Court of Appeal, they stated:

> We are willing to accept the proposition that if there were a conflict between federal and state law, the federal law would control. Actually, we have been unable to discover any substantive difference between the federal act and the California statute, at least none that has any bearing on this case.

(Petitioners' Supp. Mem. in re Arbitration in a Class Action, *supra*, at 7.)

[24] *Orr* v. *Orr*, 440 U.S. 268, 276-77 (1979) (quoting *Indiana ex rel. Anderson* v. *Brand*, 303 U.S. 95, 98 (1938)).

[25] *New York ex rel. Bryant* v. *Zimmerman*, 278 U.S. at 67.

Southland brought the class action arbitration issue to the attention of the California courts both "expressly [and] by clear intendment." Moreover, the California Supreme Court decided the issue in the context of the Federal Arbitration Act, which the court and the parties recognized to be the governing law. This Court therefore has appellate jurisdiction.[26]

II. THE FEDERAL ARBITRATION ACT SUPERSEDES THE ANTI-ARBITRATION POLICY OF THE CALIFORNIA FRANCHISE INVESTMENT LAW

The Federal Arbitration Act was enacted in 1925 for the specific purposes of (i) allowing parties to avoid the costliness and delays of litigation and (ii) overruling anti-arbitration policies of various jurisdictions, where interstate commerce is involved.[27] In order to ensure that parties to contracts would be able to resolve their disputes in an informal, nonjudicial forum of their choice,

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[26] Appellees argued in their Motion to Dismiss, at 8, that this Court does not have appellate jurisdiction over the class arbitration issue since no state "statute" was challenged. This is incorrect, as Southland challenged the applicability of the state class action rules to an arbitration proceeding under the Federal Act, which is sufficient to constitute a challenge to a statute. *See Lathrop* v. *Donohue*, 367 U.S. 820, 821, 824-27 (1961). *Cf. In re Griffiths*, 413 U.S. 717 (1973); *Mayer* v. *City of Chicago*, 404 U.S. 189 (1971). *See also King Mfg. Co.* v. *City Council*, 277 U.S. 100, 103-04 (1928); *Williams* v. *Bruffy*, 96 U.S. 176, 183 (1877).

Regardless of whether a state "statute" was challenged, Section 1257(2) clearly applies to the other issue raised by this appeal (federal preemption of the California Franchise Investment Law); the Court therefore has jurisdiction over the entire case. *Cox Broadcasting Corp.* v. *Cohn*, 420 U.S. at 487 n.14.

[27] *See* S. Rep. No. 536, 68th Cong., 1st Sess. 2-3 (1924); *Scherk* v. *Alberto-Culver Co.*, 417 U.S. 506, 510-11 (1974). *See also* H.R. Rep. No. 96, 68th Cong., 1st Sess. 1-2 (1924); *Arbitration of Interstate Commercial Disputes: Joint Hearings on S. 1005 and H.R. 646 Before the Subcomms. of the Comms. on the Judiciary*, 68th Cong., 1st Sess. 34-35 (1924) (brief submitted by American Bar Association).

Congress explicitly provided in Section 2 of the Act that an arbitration agreement in any maritime transaction or contract evidencing a transaction involving interstate commerce "*shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.*" 9 U.S.C. § 2 (emphasis supplied).

Section 2 establishes "a liberal federal policy favoring arbitration agreements, notwithstanding any state substantive or procedural policies to the contrary." *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4162. It creates "a body of federal substantive law of arbitrability" and is binding on "state courts, as [well] as federal courts . . . ." *Id.*

The statute establishes only one exception to the rule that arbitration agreements are "valid, irrevocable, and enforceable," namely, doctrines that exist at law or in equity "for the revocation of any contract." 9 U.S.C. § 2. The plain meaning of these words is that arbitration agreements can be invalidated only on the basis of *general principles* of contract formation that are applicable to *any* contract (*e.g.*, fraud, duress, lack of legal capacity), and not on the basis of restrictive laws or doctrines that are aimed at arbitration agreements in particular. Section 2 has been so interpreted by the courts.[28]

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[28] *E.g.*, *American Airlines, Inc.* v. *Louisville & Jefferson County Air Board*, 269 F.2d 811, 816-17 (6th Cir. 1959) (holding that except for "ordinary contract principles" such as "fraud, lack of consideration or capacity or authority to contract," Kentucky policies relating to enforcement of arbitration agreements "must yield to paramount Federal law" under Section 2 of the Act); *World Brilliance Corp.* v. *Bethlehem Steel Co.*, 342 F.2d 362, 364 (2d Cir. 1965) (Section 2 of the Act only permits rescission "for reasons such as fraud, duress, or undue influence"); *Collins Radio Co.* v. *Ex-Cell-O Corp.*, 467 F.2d 995, 997-98 (8th Cir. 1972) ("The plain meaning of § 2 is that federal courts are no longer to apply state statutes and decisions which limit arbitration agreements with rules not applicable to other contracts."); *Medical Development*

In the case at bar, the California Supreme Court held that the state's Franchise Investment Law renders arbitration agreements unenforceable with respect to causes of action brought by franchisees under that statute. A section of that statute, Cal. Corp. Code § 31512, provides that any contractual provision requiring a franchisee to waive compliance with the Franchise Investment Law shall be void. The court ruled that an arbitration agreement constitutes a "waiver" of the right that otherwise would exist to sue in court and, accordingly, that such agreements should not be enforced. Under the court's decision, the arbitration agreement is invalid regardless of whether it was entered into voluntarily by persons with legal capacity, whether it satisfies all other requisites for the making of a valid contract, or whether it provides for an impartial decision under rules such as those of the American Arbitration Association.[20] In other words, the statute invalidates arbitration agreements between franchisors and franchisees irrespective of whether the agreements are valid under general principles of law and equity governing the revocation of contracts.

As applied to interstate contracts such as the ones involved here, the California statute directly contravenes

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Corp. v. *Industrial Molding Corp.*, 479 F.2d 345, 348 (10th Cir. 1973) (same); *Commonwealth Edison Co.* v. *Gulf Oil Corp.*, 541 F.2d 1263, 1269-70 (7th Cir. 1976) (same); *Supak & Sons Mfg. Co.* v. *Pervel Industries, Inc.*, 593 F.2d 135, 137 (4th Cir. 1979) ("While we agree with . . . *Collins Radio* . . . that § 2 is preemptive of conflicting state laws which restrict the validity or enforceability of arbitration agreements, § 2-207 [of the U.C.C.] is not such a law, but is rather a general rule of contract formation.").

[20] The California Supreme Court did not base its decision on any finding that the 7-Eleven arbitration agreement is one-sided or that it would give any unfair advantage to the franchisor. The arbitration clause in the 7-Eleven franchise agreement stipulates that the rules of the American Arbitration Association shall be applied. These established rules, which have been incorporated into tens of thousands of commercial agreements across the country, provide, *inter alia*, for the selection of neutral arbitrators. *See* American Arbitration Association, *Commercial Arbitration Rules* (1982).

Section 2 of the Federal Arbitration Act. It is therefore invalid under the Supremacy Clause of the Constitution (art. VI, cl. 2), which preempts any state statute that "is in direct conflict with federal law, . . . denies rights granted by Congress, or . . . stands as an obstacle to the full effectiveness of a federal statute." *Colorado Anti-Discrimination Commission* v. *Continental Air Lines, Inc.*, 372 U.S. 714, 722 (1963) (footnotes omitted).[30] Under this standard, the California Franchise Investment Law must give way: it directly conflicts with Congress' declaration that interstate arbitration agreements shall be "valid, irrevocable, and enforceable"; it denies a right that is specifically granted by the federal legislation; and it stands in the path of the accomplishment of the objectives of the federal statute—*i.e.*, to invalidate anti-arbitration policies and to place arbitration agreements "upon the same footing as other contracts." H.R. Rep. No. 96, 68th Cong., 1st Sess. 1 (1924).

The California Supreme Court mistakenly relied upon this Court's decision in *Merrill Lynch, Pierce, Fenner & Smith, Inc.* v. *Ware*, 414 U.S. 117 (1973), in support of its conclusion that the California statute is not preempted. (J.S. App. 17a-18a.) *Ware* simply held that the particular state statute at issue in that case was not preempted by a particular federal statute because there was no conflict between them. *Ware* is distinguishable from the case at bar,[31] and indeed, the preemption principles

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[30] *See also Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1941); *Perez* v. *Campbell*, 402 U.S. 637, 649 (1971); *Chicago & N.W. Transp. Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 317-18 (1981); *Maryland* v. *Louisiana*, 451 U.S. 725, 746-47 (1981).

[31] *Ware* involved an alleged conflict between a state labor code provision exempting wage disputes from arbitration and a New York Stock Exchange rule providing for compulsory arbitration of wage disputes between members of the exchange and their employees. This Court found that there was no conflict between the policies underlying the state statute and the policies underlying the federal securities laws (pursuant to which the stock exchange had

summarized in that case dictate the opposite conclusion here. Unlike the situation in *Ware*, the California statute at issue in this case "frustrates [a] part of the purpose of the federal legislation." 414 U.S. at 139.

The California Supreme Court attempted to justify its decision by analogizing the state Franchise Investment Law to the federal Securities Act of 1933, both of which require disclosures to prospective investors. It reasoned that since this Court had declared in *Wilko* v. *Swan*, 346 U.S. 427 (1953), that preexisting arbitration agreements are nonbinding as to claims arising under the federal statute, the same result should pertain to claims arising under the analogous California statute.

The analogy to *Wilko* is invalid on several grounds.[32] The most important is that *Wilko* did *not* involve a conflict

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promulgated its compulsory arbitration rule), and accordingly held that the state legislation was not preempted by the stock exchange rule. *Ware* did not involve an alleged conflict between a state law and the Federal Arbitration Act. Therefore, as the California Supreme Court acknowledged, "the holding in the case is consequently not controlling here . . . ." (J.S. App. 18a.)

[32] As the dissenting justices in the California Supreme Court recognized, the 1953 decision in *Wilko* was based on this Court's conclusion that arbitration of a securities claim might cause a claimant to waive the specific benefit of the unusually liberal venue provision in the Securities Act of 1933. (*See* J.S. App. 31a-32a.) This Court has suggested that *Wilko* may have been based on that narrow ground. *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 513-14. The California Franchise Investment Law does not contain a broad venue provision or any other unique benefit similar to the one contained in the federal Securities Act.

Other courts have held that in view of the strong federal policy *favoring* arbitration, the *Wilko* "analogy" should not be extended to other situations. *See Ingbar* v. *Drexel Burnham Lambert Inc.*, 683 F.2d at 605 (rationale of *Wilko* does not extend to claims under Commodities Exchange Act); *Romnes* v. *Bache & Co.*, 439 F. Supp. 833, 838 (W.D. Wis. 1977) (same); *Middle East Transcontinental, Inc.* v. *Onion Crock, Inc.*, 144 Mich. App. 57 (1982) (*Wilko* rationale inapplicable to claims under Michigan Franchise Investment Law).

between a *federal statute* regulating contracts in interstate commerce and a *state law* purporting to limit the federal statute. Rather, *Wilko* involved two federal laws, and the Court in that case was simply called upon to determine whether a particular provision in the subsequently-enacted federal Securities Act of 1933 created an exception to the Federal Arbitration Act of 1925. For this reason, the *Wilko* "analogy" has been held to be inapplicable to conflicts between the Federal Arbitration Act and state laws. For example, in *Allison* v. *Medicab International, Inc.*, 92 Wash. 2d 199, 597 P.2d 380, 382-83 (1979), which involved a state franchise disclosure statute similar to California's, the court stated:

> Plaintiff cites *Wilko* v. *Swan*, . . . where the Supreme Court refused to enforce an arbitration clause when the dispute arose under the federal securities act. However, this case involved two federal acts and not as here the federal arbitration act and a state franchising act. . . .
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> . . . .
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> We hold that the supremacy clause of the federal constitution must prevail and thus the federal arbitration act requires enforcement of the arbitration clause in the franchise agreement despite the judicial remedies afforded by the [state] Franchise Investment Protection Act.[33]

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[33] *Accord, Barron* v. *Tastee Freez International, Inc.*, 482 F. Supp. 1213, 1216-17 (E.D. Wis. 1980) (Federal Arbitration Act prevails over any anti-arbitration policy of the Wisconsin Franchise Investment Act). In the instant case, the three-judge panel of the California Court of Appeal, as well as the two dissenting justices in the California Supreme Court, agreed that the federal policy favoring arbitration supersedes any effort by California to prohibit arbitration covered by the Federal Arbitration Act. (J.S. App. 31a-37a, 66a-70a.) *See also, e.g., Bache Halsey Stuart Shields, Inc.* v. *Moebius*, 531 F. Supp. 75 (E.D. Wis. 1982); *R.J. Palmer Construction Co.* v. *Wichita Band Instrument Co.*, 7 Kan. App. 2d 363, 642 P.2d 127 (1982); *Merrill Lynch Pierce Fenner & Smith Inc.* v. *Melamed*, 405 So. 2d 790 (Fla. Dist. Ct. App. 1981).

The California Supreme Court conceded that the Federal Arbitration Act overrides any state policy that might be hostile "to arbitration generally" (J.S. App. 15a), but it stated that the Act allows the states to adopt "exceptions" to the general principle of arbitrability. (J.S. App. 16a.) The California court made no effort to define the subject areas or scope of the permissible "exceptions," and there is in fact no principled basis for its decision. This year's exception could be for franchisor-franchisee disputes, next year's could be for disputes between lenders and borrowers or landlords and tenants, and the following year the state might ban the arbitration of tort claims. The state could easily identify a "public policy" supporting a wide range of such "exceptions," and could thereby undermine the federal statute. More fundamentally, the California Supreme Court's rationale is contradicted by the express language of Section 2 of the Arbitration Act, which overrides "any state substantive or procedural policies to the contrary." *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4162.

The California court's decision would also impair arbitration by inviting "unseemly and mutually destructive jockeying by the parties to secure tactical litigation advantages." *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 516-17. A party desiring to avoid arbitration could, through artful pleading, structure his claims so as to fit within one of the state-created "exceptions" to arbitration.[34] This

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[34] This case offers a good example of the possibilities for such maneuvering. The claim in this litigation is that Southland misled the plaintiffs by misstating and failing to disclose material facts at the time they franchised their 7-Eleven stores. Accordingly, the primary allegation in plaintiffs' original pleadings was that Southland had engaged in intentional and negligent fraud in violation of common law. However, after the trial court ruled that claims based on the California Franchise Investment Law were nonarbitrable, new complaints were filed in two of the consolidated cases (*Coy* and *Scovis*); these pleadings contained a single count, based on the

Court should not countenance such results. Just as the stability of international business transactions would be undercut if one country were to refuse to enforce international arbitration agreements based on parochial concerns, *Scherk* v. *Alberto-Culver Co.*, 517 U.S. at 516-17, orderliness and predictability in interstate commerce would be impaired if individual states were free to create "exceptions" to the arbitrability of disputes involving interstate contracts.

It is also important to prevent the erosion of the Federal Arbitration Act because of the statute's important role in the administration of justice. Court congestion and delay were among the primary reasons for enacting the statute in 1925, and are now of far greater proportions.[35]

Franchise Investment Law. Plaintiffs' counsel candidly conceded to the trial court that they had phrased the claims as statutory violations, and not as common law causes of action, for the express purpose of avoiding the contractual commitment to arbitrate the disputes. *See* [Plaintiffs'] Memorandum of Points and Authorities in Opposition to Petition to Compel Arbitration, July 17, 1978, at 3-4, where plaintiffs' attorneys stated to the trial court:

> [M]ay these plaintiffs . . . avoid arbitration by limiting their complaints to causes of action under the Franchise Investment Law? The answer to this question is clearly: yes, of course they can. . . . Having had the benefit of guidelines provided by the Court, plaintiffs' counsel have filed pleadings best calculated to both present the essential claims of the particular plaintiffs involved, and to plead an effective class action . . . .

[35] From 1940 to 1982, annual federal district court civil case filings increased from approximately 35,000 to 206,000. Federal civil cases increased almost six times as fast as population, and despite a significant increase in the number of federal district court judges, the yearly civil filings per judgeship doubled between 1940 and 1982, from approximately 180 to 400 cases. Class action cases are responsible for a significant degree of the burdens imposed upon judges. *See* Administrative Office of the United States Courts, *1982 Annual Report of the Director* 3 (prelim. ed. 1982); Administrative Office of the United States Courts, *1981 Annual Report of the Director* 3-4, 56-59, 82-83 (prelim. ed. 1981); Administrative Office of the United States Courts, *1980 Annual Report of the Director* 2-4,

Therefore, the courts have recognized that arbitration should be encouraged and that the Federal Arbitration Act should be applied in a liberal fashion in favor of enforcing arbitration agreements. *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4162, 4161 n.27.

Quite recently, Congress has explicitly reaffirmed the desirability of arbitration as an alternative to costly, time-consuming litigation in the courts. In the patent and trademark appropriations bill for 1983-85, Pub. L. No. 97-247, 96 Stat. 317 (1982), Congress overruled a line of lower court decisions which had held that "public policy" precluded arbitration of disputes concerning patent validity or infringement. *Id.* § 17(b), 96 Stat. 322 (to be codified at 35 U.S.C. § 294). In explaining this provision, the House Report emphasized that arbitration benefits not only the parties to a particular dispute but also the public at large by reducing the burdens on the courts:

> The advantages of arbitration are many: it is usually cheaper and faster than litigation; it can have simpler procedural and evidentiary rules; it normally minimizes hostility and is less disruptive of ongoing and future business dealings among the parties; it is often more flexible in regard to scheduling of times and places of hearings and discovery devices; and, arbitrators are frequently better versed than judges and juries in the area of trade customs and the technologies involved in these disputes.
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> The enforcement of voluntary arbitration would serve the public in two ways. First, . . . [it] will enhance the patent system . . . . Secondly, arbitration

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54-58 (1980); Burger, *Isn't There a Better Way*, 68 A.B.A.J. 274, 275 (1982) (address to ABA). *See also* Kirkham, *Problems of Complex Civil Litigation*, 83 F.R.D. 497, 499-501 (1979) (congestion in courts). The congestion is not confined to the federal courts. *See, e.g., Judicial Conference for the District of Columbia Circuit*, 89 F.R.D. 169, 175 (1980) (remarks of Burger, C.J.).

could relieve some of the burdens on the overworked Federal courts. Chief Justice Burger in his speech to the American Bar Association on January 24, 1982, generally endorsed the use of arbitration to reduce the judicial backlog.[36]

In sum, state-created "exceptions" to the Federal Arbitration Act would fly in the face of the language of Section 2 of the federal statute; frustrate Congress' intent to establish a national policy favoring arbitration of interstate commercial disputes; encourage parties to end-run their arbitration agreements and engage in forum shopping; and add to the burdens of crowded court dockets. For all of these reasons, this Court should reverse the decision of the California Supreme Court.

III. CLASS ACTIONS ARE INCONSISTENT WITH ARBITRATION UNDER THE FEDERAL ARBITRATION ACT

The procedures of arbitration and class actions are fundamentally incompatible. The proceeding authorized by the court below would be an arbitration in name only and would deprive the parties of the informal, nonjudicial procedure protected by the Federal Arbitration Act.

A. The Essence of Arbitration Is Its Avoidance of Judicial Procedures; Class Actions Require Active Judicial Involvement

Arbitration is a contractual method of dispute resolution that is intended to take place outside of the judicial system, without interference by the courts and without

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[36] H.R. Rep. No. 542, 97th Cong., 2d Sess. 13 (1982), *reprinted in* 1982 U.S. Code Cong. & Ad. News 765, 777. Another recent statute in which Congress has stressed the need for developing viable alternatives to litigation in the courts is the Dispute Resolution Act, Pub. L. No. 96-190, 94 Stat. 17 (1980) (codified at 28 U.S.C. app. §§ 1-10 (Supp. V 1981)). *See also* H.R. Rep. No. 1654 (Part 1), 95th Cong., 2d Sess. 7-11 (1978); *Report of the Pound Conference Follow-Up Task Force*, 74 F.R.D. 159, 169, 179-81 (1976) (discussing the advantages of arbitration and recommending its increased use).

adherence to conventional judicial procedures. By choosing arbitration, parties agree to forego full judicial procedures and instead elect to have one or more umpires of their choosing, often experts in the subject matter of the dispute, hold an informal hearing and reach a prompt decision. The arbitrators enjoy wide latitude in conducting the proceedings. Judicial machinery—such as pretrial discovery, the rules of evidence, the automatic right to appeal, a written transcript, and the necessity of rendering carefully articulated written decisions—are not applicable. Parties frequently conclude that lawyers are unnecessary in this informal setting. Moreover, arbitrators—unlike courts—need not consider the impact of their decision as precedent that may be applicable to nonparties to the controversy; arbitration thereby facilitates prompt decisions and discourages parties from overlitigating a dispute because of concerns that an adverse decision may extend beyond the particular facts at issue.[37]

Waiver of judicial procedures goes to the heart of arbitration. Arbitration "isn't 'just like the courts.' In fact, its strongest points lie in those areas where it most widely differs from the courts." M. Domke, *The Law & Practice of Commercial Arbitration* § 1.01, at 2. Thus, it has repeatedly been held that arbitration should not be encumbered with procedures that might delay or complicate the proceedings, or require judicial intervention when

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[37] *See, e.g., Bernhardt* v. *Polygraphic Co. of America*, 350 U.S. 198, 203 & n.4 (1956); *United Steelworkers* v. *Enterprise Wheel & Car Corp.*, 363 U.S. 593, 598 (1960). For a discussion of the informality of arbitration and its differences from judicial litigation, *see generally* A. Widiss, *Arbitration: Commercial Disputes, Insurance, & Tort Claims* 6-7, 339 (PLI 1979); M. Domke, *The Law & Practice of Commercial Arbitration* § 24.02 at 235-39, § 24.07 at 252, § 25.01 at 255-56, § 26.01 at 265-66, § 27.01 at 271-72, § 29.06 at 286-89, and pp. 312-13 (1968); Rehnquist, *A Jurist's View of Arbitration*, 32 Arb. J. 1, 5-7 (1977).

the arbitration is in progress.[38] As Judge Learned Hand stated in *American Almond Products Co.* v. *Consolidated Pecan Sales Co.*, 144 F.2d 448, 451 (2d Cir. 1944):

> Arbitration may or may not be a desirable substitute for trials in courts; as to that the parties must decide in each instance. But when they have adopted it, they must be content with its informalities; they may not hedge it about with those procedural limitations which it is precisely its purpose to avoid.

The court below has not only "hedged" the arbitration with judicial procedures; it has created a mechanism that would be conducted by the judiciary from start to finish.

Class actions are the paradigm example of large, time-consuming, rigorously-regulated, difficult-to-manage judicial proceedings. They require more judicial supervision than do other court proceedings, and more rigid adherence to formalities. Because they bind the rights of persons who have not sued or personally appeared and who do not control the lawsuit, class actions pose delicate constitutional issues. They satisfy federal due process standards only if, and to the extent that, the named plaintiff's claim is typical of those of other class members, the best practicable notice is given to the class, and the named plaintiff and his counsel fully and adequately represent the interests of the class.[39]

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[38] *See, e.g., Prima Paint Corp.* v. *Flood & Conklin Mfg. Co.*, 388 U.S. at 404; *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4161; *Cavanaugh* v. *McDonnell & Co.*, 357 Mass. 452, 457, 258 N.E.2d 561, 564 (1970); *De Sapio* v. *Kohlmeyer*, 35 N.Y.2d 402, 406, 362 N.Y.S.2d 843, 847, 321 N.E.2d 770, 773 (1974).

[39] *See, e.g., Hansberry* v. *Lee*, 311 U.S. 32, 42-43, 45 (1940); *Sam Fox Publishing Co.* v. *United States*, 366 U.S. 683, 691 (1961); *H.L.* v. *Matheson*, 450 U.S. 398, 432 n.9 (1981) (Marshall, J., dissenting); *Robertson* v. *National Basketball Ass'n*, 556 F.2d 682, 685-86 (2d Cir. 1977); *Gonzales* v. *Cassidy*, 474 F.2d 67, 74 (5th Cir. 1973).

Absent class members cannot constitutionally be bound by the result of the proceeding unless there has been active judicial participation in all aspects of the litigation. For example, discovery, briefing and a hearing are usually required before the court decides whether to certify a class.[40] The court must carefully define the class, determine the best practicable form of notice to the class, and approve the content of the notice.[41] Class members then must be allowed to opt out of the litigation.[42]

After completion of these preliminary proceedings, which normally consume many months,[43] the court must continue to supervise all phases of the litigation to ensure that the named plaintiff's interests are compatible with those of the class and that plaintiff is a vigorous and effective class representative.[44] If, at *any* time, the initial class certification appears to have been erroneous, the class

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[40] *See General Telephone Co.* v. *Falcon*, 457 U.S. 147, 102 S. Ct. 2364, 2372 (1982) (often necessary to "probe behind the pleadings" to decide class issues); *Coopers & Lybrand* v. *Livesay*, 437 U.S. at 469 & n.12 (class certification issues usually " 'enmeshed in the factual and legal issues comprising the plaintiff's cause of action' "); *Alabama* v. *Blue Bird Body Co.*, 573 F.2d 309, 312, 322-24 (5th Cir. 1978); *Belcher* v. *Bassett Furniture Industries, Inc.*, 588 F.2d 904, 906 (4th Cir. 1978).

[41] *Oppenheimer Fund, Inc.* v. *Sanders*, 437 U.S. 340, 357 n.24 (1978); *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. at 173-74.

[42] Fed. R. Civ. P. 23(c). (*See also* the decision of the California Supreme Court at J.S. App. 28a.)

[43] Frequently, a year or more will be consumed in class action discovery, briefing and hearings alone. *See, e.g., In re Transit Co. Tire Antitrust Litigation*, 67 F.R.D. 59, 63, 72 (W.D. Mo. 1975); *Sommers* v. *Abraham Lincoln Federal Savings & Loan Ass'n*, 66 F.R.D. 581, 585 (E.D. Pa. 1975).

[44] *E.g., In re Fine Paper Antitrust Litigation*, 617 F.2d 22, 27 (3d Cir. 1980); *Susman* v. *Lincoln American Corp.*, 561 F.2d 86, 89-90 (7th Cir. 1977); *National Ass'n of Regional Medical Programs, Inc.* v. *Mathews*, 551 F.2d 340, 344-46 (D.C. Cir. 1976), *cert. denied*, 431 U.S. 954 (1977).

must be realigned or decertified.[45] And if the claims are amended, or if other significant events occur, the court may require or authorize supplemental notices to the class.[46] If either the plaintiff or the defendant wishes to communicate with class members, the court may need to act to prevent misrepresentations or other abuses.[47]

The court's supervisory duties in a class action also extend to the actual hearing of the case and to any proceedings that occur thereafter. The court must ensure that the named plaintiff's evidence is "common," class-wide evidence.[48] Transcripts of the proceedings must be prepared, and the court must render written decisions, so that other courts can ascertain the scope of the class and of the judgment. Moreover, even if the court's decision has been clearly delineated, a class member can appeal from an adverse verdict, or attempt to avoid the res judicata effects thereof, by contending that the evidence was not "common" and/or that he was not adequately represented; if these requirements were not satisfied, the verdict cannot be binding on him.[49] In a class action, the

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[45] *General Telephone Co.* v. *Falcon*, 102 S. Ct. at 2372; *Coopers & Lybrand* v. *Livesay*, 437 U.S. at 469 & n.11; *H.L.* v. *Matheson*, 450 U.S. at 432 n.11 (Marshall, J., dissenting); *Social Services Union, Local 535* v. *County of Santa Clara*, 609 F.2d 944, 948-49 (9th Cir. 1979); *Guerine* v. *J & W Investment, Inc.*, 544 F.2d 863, 864 (5th Cir. 1977).

[46] *See, e.g.*, Fed. R. Civ. P. 23(d)(2); 7A C. Wright & A. Miller, *Federal Practice & Procedure* § 1791 at 193-94, § 1793 at 201, 207-11 (1972).

[47] *Gulf Oil Co.* v. *Bernard*, 452 U.S. 89, 100 (1981).

[48] *See General Telephone Co.* v. *Falcon*, 102 S. Ct. at 2372. After trial of the "common" issues, there may be hundreds of additional hearings on "individual" issues, such as damages. *E.g.*, *International Brotherhood of Teamsters* v. *United States*, 431 U.S. 324, 361 (1977); *EEOC* v. *Korn Industries, Inc.*, 682 F.2d 256, 260-61 (4th Cir. 1981).

[49] *E.g.*, *Gonzales* v. *Cassidy*, 474 F.2d 67 (5th Cir. 1973).

parties cannot even settle their dispute without judicial review and approval.[50]

In short, class actions require intimate, ongoing judicial management at every stage.

The California Supreme Court recognized that these essential class action procedures, which arise from due process considerations, cannot properly be performed by arbitrators. It therefore acknowledged that in a purported class action arbitration, *the court* would conduct the certification proceedings, monitor the adequacy of representation, review any proposed settlements, and so forth. (J.S. App. 28a-29a. *See also* the decision of the Court of Appeal at J.S. App. 64a.) The court attempted to downplay the extent to which a judge would be involved but conceded that the judiciary would be required to participate actively throughout the arbitration.

B. A Class Action Arbitration Would Violate the Federal Arbitration Act by Destroying the Parties' Agreement To Arbitrate

It is difficult to imagine a procedure more alien to the spirit of arbitration. The mechanism contemplated by the court below would seriously affect the viability of the rights guaranteed by the Federal Arbitration Act in many ways. For example:

—a procedure designed to operate outside the judicial system would require careful and continuous judicial participation;

—a mechanism intended to operate informally would be transformed into one involving detailed, legalistic procedures;

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[50] *In re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106, 1124 & n.21 (7th Cir.), *cert. denied*, 444 U.S. 870 (1979); *Mandujano* v. *Basic Vegetable Products, Inc.*, 541 F.2d 832, 835-36 (9th Cir. 1976); *Grunin* v. *International House of Pancakes*, 513 F.2d 114, 120-24 (8th Cir.), *cert. denied*, 423 U.S. 864 (1975); *Greenfield* v. *Villager Industries, Inc.*, 483 F.2d 824, 831-34 (3d Cir. 1973); *Officers for Justice* v. *Civil Service Commission*, 688 F.2d 615, 624-25 (9th Cir. 1982). *See also* Fed. R. Civ. P. 23(e).

—a procedure designed to simplify the litigation would become more complex than if the litigation had remained in court in the first place; the parties would litigate their dispute in two forums rather than one, and there would be substantial overlaps between the roles of the judge and arbitrator;

—a mechanism intended to be quick and inexpensive would become protracted and expensive;

—a procedure designed to permit parties to resolve a dispute privately, and without disrupting ongoing contractual relationships, would become a highly publicized, high-stakes lawsuit;

—a procedure designed to facilitate compromise would inhibit settlements by burdening them with costly and time-consuming procedural hurdles; and

—parties would be less willing to enter into arbitration agreements since the risks associated with arbitration would be significantly increased while its efficiency and privacy would be diminished.

Class actions and arbitrations are each a useful procedural tool for resolving disputes. This Court need not decide that one is good and the other bad. But the two are like oil and water and cannot be mixed; the use of both at the same time would not be true to the objectives or procedures of either. One emphasizes speed, simplicity, informality and privacy, while the other requires caution, complexity, strict adherence to established procedures, and publicity. As the dissenting opinion in the court below aptly noted, a class action arbitration necessarily would "require close court supervision and frequent intervention antithetical to the essential informal and nonjudicial nature of the arbitration process." (J.S. App. 45a.)[81]

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[81] The fundamental inconsistency between the two types of proceedings was recognized in the only other reported decision to consider the propriety of a class action arbitration. In *Harris* v. *Shearson Hayden Stone, Inc.*, 82 A.D.2d 87, 441 N.Y.S.2d 70, 75-76 (1981), *aff'd mem.*, 56 N.Y.2d 627, 450 N.Y.S.2d 482, 435 N.E.2d

The California Supreme Court ignored this incompatibility and justified its decision by erroneously assuming that individual, small claims might be "effectively foreclos[ed]" unless claimants are able to aggregate their resources by bringing class actions. (J.S. App. 25a.) The court overlooked the fact that the objectives of class actions (relieving burdens on the courts, reducing the cost of prosecuting individual claims) are served by arbitration in another way. Arbitration assists the administration of justice by consensually removing cases from the often tortuous route of the judicial system and by providing a quick, informal, inexpensive remedy to facilitate the prosecution of claims—particularly small claims. In other words, arbitration satisfies the principal goals that led to the creation of class actions without the delay, burden and expense which accompanies that judicial procedure. *Cf. Harris* v. *Shearson Hayden Stone, Inc.*, 441 N.Y.S.2d at 76.[52]

The California Supreme Court was unrealistic when it suggested that hundreds of individual, duplicative arbitrations would occur unless it created an unprecedented class action procedure. (*See* J.S. App. 25a, 29a.) The court cited no evidence that this sort of wasteful practice has occurred, and we believe that none exists for several reasons. First, the typical case involves only one or a few

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1097 (1982), the court held that a party should not be permitted to avoid arbitration of his individual claim by filing a class action in court. A dissenting justice felt that the policy favoring class actions should prevail over the policy favoring arbitration, but even he recognized that a class action necessarily is a *judicial* procedure, unsuited to the arbitration setting. 441 N.Y.S.2d at 79.

[52] Our research has not revealed any studies or commentary supporting the proposition that individual arbitration has tended to thwart the prosecution of individual claims. Nor, prior to the decisions of the California courts in this case, was there any support for that proposition in case law. Moreover, in the court below, the plaintiff-franchisees did not allege that it would be impossible or impractical to prosecute individual claims. Indeed, all of the plaintiffs are represented by the same attorneys and yet they filed some of the cases individually and some as purported class actions.

claims, not hundreds or thousands. Class actions stir up litigation to some extent by creating claimants who have not previously felt aggrieved and who are not affirmatively interested in filing suit.[53] Thus, the true alternative to a class action in the instant litigation—and most others—is arbitration with a few claimants, not hundreds. Second, even if hundreds of claims were asserted, it is wrong to assume that it would be necessary to duplicate the expense of individually arbitrating each one. Substantial economies could be achieved by retaining the same attorneys (as plaintiffs have done here), hiring the same expert witnesses, and so forth. Third, if a number of arbitrations were decided in favor of one side or the other, the parties would likely conform their conduct to the results of those arbitrations, or the arbitrators would give precedential weight to the outcome of prior cases. Fourth, in positing that the "alternatives" were a single class action or hundreds of individual hearings, the court below overlooked the fact that a class action arbitration would *not* eliminate the need for individual trials on "non-common" issues such as damages, affirmative defenses and counterclaims.

In any event, the Federal Arbitration Act does not authorize the courts to interfere with arbitration on the ground that some other procedure would be more "efficient." *See Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4161. An agreement to arbitrate is, in effect, "a specialized kind of forum-selection clause that posits not only the situs of the suit but also *the procedure to be used* in resolving the dispute." *Scherk* v. *Alberto-Culver Co.*, 417 U.S. at 519 (emphasis supplied). And, as the court stated in *Dickinson* v. *Heinold Securities, Inc.*, 661 F.2d 638, 646 (7th Cir. 1981):

> [T]he Arbitration Act requires that we enforce the bargain of the parties as to dispute resolution and

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[53] *Cf. Gulf Oil Co.* v. *Bernard*, 452 U.S. at 100 nn.11 & 12 (potential of class action for "stirring up" litigation).

> not substitute our own views of economy and efficiency. There is no room in the language of the Act, the decisions of the Supreme Court or the decisions of this court for an ad hoc approach, based on speculative considerations of efficiency toward enforcement of arbitration agreements.[54]

The Federal Arbitration Act must be enforced by state courts, and it prevails over "any state substantive *or procedural* policies to to the contrary." *Moses H. Cone Mem. Hosp.* v. *Mercury Constr. Corp.*, 51 U.S.L.W. at 4162 (emphasis supplied). Thus, appellees' contention that the states are free to encumber interstate arbitrations with judicial paraphernalia so long as they do so with "procedural" devices is without merit. (*See* Motion to Dismiss at 10-14.)

The California Supreme Court recognized that its class action device would be radically different than a normal arbitration and accordingly held that a party "should be given the option of remaining in court rather than submitting to classwide arbitration." (J.S. App. 30a.) A person presented with this Hobson's choice would almost surely elect the judicial forum. While parties to contracts are often willing to forego their rights of appeal, discovery, and adherence to rules of evidence in the context of an informal arbitration, waiver of these protections would involved decidedly different considerations in the context of a massive class action involving hundreds of litigants. Moreover, a class action arbitration would necessarily involve overlapping responsibility between two tribunals and would be even more complex, protracted and uncertain than a *judicial* class action. Thus, in the end, there likely would not be *any* arbitration at all: the parties would opt for the "simpler" judicial class action, and the agreement to arbitrate would be circumvented as a direct result of the judicially-imposed class action procedures.

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[54] *See also, e.g., De Sapio* v. *Kohlmeyer*, 35 N.Y.2d at 406, 362 N.Y.S.2d at 847, 321 N.E.2d at 773.

The decision of the court below would also have an adverse impact on the availability of qualified arbitrators. An arbitrator would have very little independence in the kind of two-ring proceeding contemplated by the California Supreme Court since he or she would be second-guessed by a judge at every stage. Skilled accountants, architects, contractors and other potential arbitrators would be deterred by the legalisms, complexities and judicial controls of a class action; and the prospect of presiding over hundreds of individual damage hearings after the hearing on the "common" issues would further reduce the parties' ability to obtain qualified arbitrators.

In sum, a class-action arbitration would seriously impair, if not destroy, the parties' federally protected agreement to arbitrate.

CONCLUSION

For all of the reasons stated above, the decision of the California Supreme Court should be reversed, and the cases should be remanded with the instruction that the parties should proceed to arbitrate their disputes on an individual basis.

Respectfully submitted,

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